

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
FANNON & OSMOND	:	
PHOTOGRAPHY, INC.	:	DETERMINATION
AND FANNON & OSMOND, INC.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Tax under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1980	:	
through May 31, 1984.	:	

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Petitioners, Fannon & Osmond Photography, Inc. and Fannon & Osmond, Inc., 1071 6th Avenue, New York, New York 10018, filed a petition for revision of a determination or for refund of sales and use tax under Articles 28 and 29 of the Tax Law for the period March 1, 1980 through May 31, 1984 (File Nos. 803093 and 803094).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 10, 1988 at 9:15 A.M., with all briefs to be submitted by August 8, 1988. Petitioner appeared by Gerald A. Navagh, Esq. The Audit Division appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether petitioners were liable for use tax on their purchases of materials used in producing a taxable product which was sold to their clients, such as artwork, scriptwriters, graphic design, photocopying, artwork illustration, and layouts, and whether these purchases

were for resale and therefore not subject to sales or use taxes.

II. Whether petitioners' purchases of the products stated in Issue I constituted tax exempt purchases of equipment for use directly and predominantly in the production of tangible personal property.

#### FINDINGS OF FACT

1. Fannon & Osmond Photography, Inc. ("F&O Photography") and Fannon & Osmond, Inc. ("F&O"), petitioners herein, were New York corporations with an identical place of business at 1071 6th Avenue, New York, New York during the audit period, March 1, 1980 through May 31, 1984. However, the notice of determination issued to F&O was for the period March 1, 1980 through August 31, 1983 and the notice of determination issued to F&O Photography covered the period June 1, 1981 through May 31, 1984. The record reveals that one James Fannon was the president of F&O and that Gerald Osmond was vice president for the period March 1, 1980 through November 30, 1983. With regard to F&O Photography, James Fannon was vice president and Gerald Osmond was president for the period June 1, 1981 through May 31, 1984. There are no other facts in the record which indicate a more substantial corporate interrelationship.

2. On December 20, 1985, the Audit Division issued to F&O a Notice of Determination and Demand for Payment of Sales and Use Tax Due setting forth tax due in the sum of \$26,268.44, penalty of \$6,567.13 and interest of \$16,362.80, for a total of \$49,198.37. A second notice was issued to F&O on the same date for the period September 1, 1983 through November 30, 1983 setting forth tax due of \$1,900.98, penalty of \$475.24 and interest of \$588.91, for a total amount due of \$2,964.89.

3. On December 20, 1985, the Audit Division issued to F&O Photography a Notice of Determination and Demand for Payment of Sales and Use Taxes Due setting forth a total tax due of \$3,994.81, penalty of \$991.39 and interest of \$1,700.03, for a total amount due \$6,686.23.

4. F&O, by its president and vice president, executed consents extending the period of limitation for assessment of sales and use taxes for the period March 1, 1980 through August 31, 1982 to December 20, 1985.

F&O Photography, by its president and vice president, executed consents extending the period of limitation for assessment of sales and use taxes for the period June 1, 1981 through August 31, 1982 to December 20, 1985.

5. The assessments issued against F&O and F&O Photography set forth in Finding of Fact "3" above, were the result of field audits and the amount of tax assessed represents use tax.

With regard to F&O Photography, for the audit period June 1, 1981 through May 31, 1984, it was found that F&O Photography had adequate records, that gross receipts per ST-100's, federal returns and books and records of the corporation were reconciled for the fiscal years 1981, 1982 and 1983. Furthermore, a test of nontaxable sales indicated that all were substantiated and Audit disallowed none of said sales. A detail of analysis was made of purchase invoices for the entire audit period with regard to production expenses and the Audit Division found use tax due on said purchases in the sum of \$2,777.72. Additionally, a detailed analysis of fixed asset purchases for the audit period resulted in a use tax due of \$1,217.12. The use tax assessed on fixed asset purchases was not contested by F&O Photography at hearing or at any time.

With regard to F&O, an audit was performed for the period March 1, 1980 through November 30, 1983 and it was found that F&O maintained an adequate set of books and records and that its gross receipts per its ST-100's, federal returns and books and records were reconcilable for the fiscal years 1981 and 1982. A test of F&O's nontaxable sales indicated that it could substantiate said sales and therefore no disallowance was made by Audit. However, as with F&O Photography, a detailed analysis of purchase invoices for production expenses was made for the entire audit period as it was for the purchase of fixed assets. Additional use tax was found due on purchases of production materials in the sum of \$27,823.53. With regard to the

purchase of fixed assets, the Audit Division found additional use tax due in the sum of \$346.03. As in the case of F&O Photography, petitioner did not contest the use tax found due on the purchase of fixed assets for the audit period.

6. Both petitioners are audio-visual production companies which specialize in producing filmed, written communications for use primarily between corporate management and sales forces. Petitioner has a complete facility for creation and production of audio-visual communications. Their productions consist mainly of multi-image slides with use of film, videotape and sound. Both petitioners employ a variety of specialists including artists, scriptwriters, designers, illustrators and mechanical specialists. These specialists are independent contractors who work for petitioners on a per job basis.

7. An examination of invoices issued by both petitioners to their customers during the audit period indicated that, on many occasions, production expenses were not broken out of such charges as design and storyboards, slide production, assembly processes, art, photography, direction, lab and production, procedures. However, testimony revealed at hearing that when a fee was charged for a presentation, including scriptwriting, typing and copying design on a storyboard, the figure on the invoice included supplies and materials used in producing the artwork such as a storyboard, and includes labor for doing the work, an estimate of what the supplies were for doing the work and a markup. It is uncontroverted that the total amount listed on the invoice was taxed at the prevailing rates.

8. Petitioners produced what is generally known as a presentation which essentially is a meeting attended by a corporate audience at which various corporate officers present new products to nationwide sales forces assembled at a meeting place for this purpose. Petitioners' responsibility was to produce the entire production from concept through production of all visual, soundtracks, scripts, storyboards, etc., and delivery of final project to the audience. The client is purchasing an effective communication with their sales force.

Generally, petitioners are referred as a producer of such presentations or they are invited to compete with other producers for specific projects. After landing an account, petitioners meet with the client, outline the parameters of the project, establish schedules, budgets, communications and otherwise initiating groundwork for the project.

The first step in the production is the establishment of budgets and schedules. The second step is assigning a scriptwriter who prepares a first draft of an audio-visual script. A storyboard is produced simultaneously with the script and cued to the script. Storyboards are produced by technical employees with design graphic abilities and knowledge of audio-visual production.

After the storyboard is approved, numerous skilled personnel in graphics photography produce mechanicals or product photographs which ultimately become slides used in the final presentation. The slides are cued to a soundtrack and this function is sometimes performed by computers.

9. As part of its production costs, petitioner purchases art supplies, photostats and prints, typography and artwork. Petitioner did not show what part of its production costs included materials which became part of the final product and were passed along to the customer and what part was equipment used in the production of its product.

#### STATEMENT OF PETITIONER'S POSITION

10. Petitioners argue that since their expense purchases were included in the invoices sent to its customers, and on which sales tax was collected, its purchases were purchases for resale and thus not subject to tax because tax was collected on the sale to its customers and could not be collected a second time on the original purchase by petitioners. Alternatively, petitioners argue that if the purchases were not for resale, then they were purchases of equipment for use directly and predominantly in the production of tangible personal property and exempt from New York State sales tax and use tax and thus, only taxable at the 4% New York City rate.

#### CONCLUSIONS OF LAW

A. This case, encompassing both petitioners, is virtually identical to a prior situation

found in Matter of Fannon/Osmond, Inc., State Tax Commission, May 20, 1983. In the prior case, the Audit Division assessed use tax on petitioner's purchases of art supplies, photostats and prints, typography, and artwork. Petitioner's arguments in the prior case were essentially the same as those asserted herein. Unfortunately, for petitioners herein, its arguments are no more valid now than they were in 1983.

B. Section 1101(b)(4)(i)(A) of the Tax Law excludes sales for resale from the tax on receipts from every retail sale of tangible personal property imposed by Section 1105(a). Inasmuch as petitioner produced no evidence showing to what extent the purchases in issue were passed along to its customers as physical component parts of its finished audio-visual products, it has failed to prove that such purchases were for resale. It is clear that petitioners herein transferred some of the materials which it purchased to its customers; however, it is equally clear that petitioners used the materials and supplies they purchased in the preparation of their audio-visual products. Therefore, the purchases were not for resale within the meaning and intent of Tax Law § 1101(b)(4) (see, Laux Advertising, Inc. v. Tully, 67 AD2d 1066; Matter of Parenti Studio, Inc., State Tax Commission, October 9, 1981; Matter of Harrison Services, Inc., State Tax Commission, January 16, 1981; and Matter Baronet Lithograph Co., State Tax Commission, August 25, 1978).

C. Section 1115(a)(12) of the Tax Law exempts from sales and use taxes receipts from the sale of machinery or equipment used directly and predominantly in the production of tangible personal property. The photostats and prints, artwork and typography and other miscellaneous art supplies and expenses purchased by petitioner constitute equipment used directly and predominantly in the production of its audio-visual products within the meaning and intent of Section 1115(a)(12) and are exempt from New York State sales and use tax. However, the aforesaid purchases are subject to the New York City local sales tax pursuant to Section 1210(a)(1) of the Tax Law (see, Matter of Parenti Studio, Inc., supra; Matter of Harrison Services, Inc., State Tax Commission, January 16, 1981).

D. [Standard A-1 Penalty Clause] and final conclusion of law denial of petition.

DATED: Albany, New York

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ADMINISTRATIVE LAW JUDGE